Committee on Ways and Means Tax Reform Working Group on Pensions and Retirement
United States House of Representatives

As the Ways and Means Tax Reform Working Group on Pensions and Retirement considers comprehensive tax reform, the Principal Financial Group® urges members to carefully review the **true** costs and benefits of current **retirement plan tax incentives.** Those incentives have helped millions of Americans save trillions of dollars. Reducing or removing those incentives would have a detrimental impact on retirement security and on the nation's economy as a whole.

As a leading provider of defined contribution plans[1] and global investment management leader, the Principal Financial Group provides comments based on more than 70 years in the retirement industry and our experience with small to medium-sized employers and their employees. We currently provide retirement services to more than 43,000 retirement plans and 4.2 million employee participants[2].

We offer the following facts for your consideration:

Retirement plan tax deferrals are not tax forgiveness.

Retirement plan tax incentives have been mischaracterized as expenditures when they are actually revenue-producers. The federal government eventually collects significant tax revenue on distributions from tax deferred retirement savings. When workers withdraw money from their retirement accounts, they generally pay ordinary income taxes not only on the original savings but also on the potential accumulated, compounded earnings.

Our analysis of a typical middle income worker shows that over the course of a 40-year career, for every $1 of taxes deferred, the federal government collects at least $4 in tax revenue when the contributions and earnings are withdrawn[3]. (See Appendix I)

With $10.5 trillion[4] currently saved in worksite retirement defined contribution plans and IRAs, the government will be collecting significant tax revenue for many years to come.

Lower tax incentives would result in fewer retirement plans for American workers.

According to The Principal® Retirement Readiness Survey[5] of small to medium-sized employers, reducing tax incentives would remove a key motivation for employers to offer retirement plans.

- Ninety-two percent of employers who offer a plan say retirement **tax incentives for employees** are important in their decision to offer a 401(k) or other defined contribution plan.
- Approximately four out of five plan sponsors (79 percent) say the **tax incentive given to employers** is important in their decision to offer a 401(k)/defined contribution plan.

With the number of defined benefit pensions plans continuing to shrink, the last thing we should do is discourage employers from offering defined contribution plans.

[1] Based on number of recordkeeping plans, PLANSPONSOR Recordkeeeping Survey , June 2012.
[2] 43,171 plans with 4,269,242 participants as of 12/31/12.
[3] Analysis by the Principal Financial Group. See Appendix I for assumptions used.
[4] Source Investment Company Institute, "Retirement Assets Total $19.5 Trillion in Fourth Quarter 2012," News Release, March 27, 2013.
[5] The Principal Retirement Readiness Survey 2011, commissioned by the Principal Financial Group and conducted by Harris Interactive online. Data was gathered May 17 through June 17, 2011 from 1,305 employers. Employers who currently do not offer a DC retirement plan, and employers who do offer DC plans, serviced by The Principal, were included in the survey.

Lower tax incentives would also result in lower overall retirement savings.

Three-quarters of employers in the Retirement Readiness Survey say current pre-tax deferral is **the most attractive retirement plan feature to employees.**

- When asked about reducing the amount of contributions employees are allowed to deduct:
  - Almost half (44 percent) of plan sponsors say employee participation would decrease.
  - Two-thirds (67 percent) of plan sponsors say employee contribution levels would decrease
- More than 80 percent of employers say **participation and contribution levels would decrease** if the incentives **were removed**. (85 percent and 86 percent respectively)
- If anything, more than half of employers (54 percent) say tax deferral limits should be ***raised,*** not lowered.

According to a recent non-partisan Employee Benefit Research Institute survey[6], American workers validate that they would save less if they could not do so on a pre-tax basis.

- Forty-five percent of workers say they would stop or reduce contributions to worksite retirement plans if they could no longer do so on a pre-tax basis.
- Lower income workers ($35,000 or less) would be much more likely to stop contributing if the tax incentive was removed**.** Twenty-four percent with incomes less than $35,000 said they would stop contributing compared to 11 percent for incomes of $35,000 to $74,000 and 17 percent of incomes over $75,000.

American workers strongly support current incentives and deeply oppose cuts.

According to a recent survey[7] by the Investment Company Institute of households with defined contribution accounts and IRAs:

- Eighty-three percent say the immediate tax savings from their retirement plans is a big incentive to contribute.
- Eighty-three percent agree that continuing to provide retirement savings incentives should be national priority.
- Eighty-nine percent are opposed to eliminating the tax advantages of defined contribution accounts.
- Eighty-eight percent oppose reducing the amount that individuals can contribute.
- Even modest-income households making less than $30,000 opposed elimination (79 percent) and reduction (73 percent) of these tax incentives.

Cutting tax incentives would harm middle to lower income workers and pre-retirees.

Non-discrimination rules and safe harbors carefully balance the benefits in 401(k) plans between higher and lower paid workers, ensuring that benefits are very progressively distributed. As a result, the tax incentives for retirement flow overwhelmingly (89%) to taxpayers whose income is under $200,000[8].

The Principal analyzed[9] participants in retirement plans for which we provide recordkeeping services who were deferring the maximum amount allowed by law in 2011. We found that **workers of all income levels** are saving up to available contribution limits and would be impacted if tax incentives were reduced:

- 43 percent of those who save the maximum tax deferred amount make less than $110,000.
- 64 percent of those who defer the maximum amount are age 50 or older, the group that has the least time to build retirement security.

Bottom line: reductions in tax incentives would have a negative impact on the very people Congress is trying to protect: **non-highly compensated workers** and **pre-retirees**.

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[6] Employee Benefit Research Institute 2013 Retirement Confidence Survey

[7] America's Commitment to Retirement Security: Investor Attitudes and Actions, ICI 2013.

[8] *Estimated Benefits of Tax Expenditure Estimates for Defined Contribution Plan Participants and Retirees with Account Balances*, prepared for The American Society of Pension Professionals and Actuaries (ASPPA), 2011.

[9] Analysis completed on a total of 1,352,372 401(k) and 403(b) plans serviced by The Principal with nearly 64,000 participants reaching the maximum deferral limits in 2011.

Limits on deductions and exclusions could also result in some double taxation.

By partially taxing the contributions of individuals whose income is above any tax preferred limits at the time of contribution to the plan and then later fully taxing all distributions from the plan, retirement savings could be subject to double taxation. This could make retirement savings disadvantageous and lead to a dramatic reduction in the formation of plans among small businesses and undermine large employers' commitment to their plans.[10]

Retirement tax incentives inject much-needed investment capital into the economy.

At the end of 2012, retirement plans held approximately $19.5 trillion[11] in assets, with almost $10.5[12] trillion held in defined contribution plans and IRAs. Those tax deferred retirement plan dollars play a vital role in developing U.S. and global capital markets. Representing about 33 percent of the value of total US publicly traded stock holdings[13], retirement assets provide a strong, steady source of capital to help companies grow, add jobs and increase wages.

Employer-sponsored 401(k) plans and other defined contribution retirement plans play a crucial role in our economy while they help build retirement security for our nation's workforce.

The overall societal benefits generated by critically important retirement savings incentives more than offset any delay in government revenue.

We urge the House Ways and Means Tax Reform Working Group on Pensions and Retirement to preserve and protect the current tax structure for defined contribution retirement plans and IRAs. We cannot achieve retirement security for all Americans by endangering the most successful retirement savings system in United States history.

Beyond preserving to enhancing:

Congress can help expand financial security for Americans by building on the current employer-sponsored system. By removing barriers to new retirement plan formation and encouraging plan designs that increase participation and savings, Congress can help more Americans have access to retirement plans and encourage them to save more effectively.

The Principal recommends the following steps:

- **Give employers reasons to offer plans and remove barriers from plan formation**
  - Increase the tax incentives for starting a plan.
  - Make it easier to set up and administer plans.
  - Lower the cost to administer plans by streamlining reporting requirements.
  - Promote policies that encourage modern communication modes such as electronic document delivery to cut down excessive cost of paper.
    - For just three clients of The Principal, complying with just one required notice to 168,000 employees took 42 tons of paper or 1,000 trees at a cost of $440,000.

[10] Attitudes of Employee Benefits Decision Makers Toward Retirement Plan Tax Proposals (Survey prepared by Mathew Greenwald & Associates Inc. and designed in collaboration with the American Benefits Institute), December 2012.
[11] Investment Company Institute, "Retirement Assets Total $19.5 Trillion in Fourth Quarter 2012," News Release, March 27, 2013.
[12] Ibid.
[13] 2011 Calculations based on Cerulli, World Bank and PSCA survey data.

- **Encourage retirement plan designs that increase savings and participation.**
    - Encourage automatic enrollment at higher deferral rates, automatic annual increases and employer matches structured to incent higher deferrals.
    - Update automatic enrollment arrangements by removing the 10 percent cap on default deferral and auto escalation.
    - Provide additional incentives to employers who use auto escalation.
    - Expand the savers credit and deposit it back into the participants retirement account.
    - Increase the limit for catch-up contributions.

- **Address the challenge of retirement income**
    - Encourage broader use of retirement income illustrations on benefit statements to drive home how long savings will last in retirement.
    - Provide tax incentives and clarify ERISA regulations to alleviate fiduciary concerns and encourage plan sponsors to voluntarily provide education about and access to income annuities at the worksite.

- **Enhance each part of the U.S. retirement system.**
    - Support existing defined benefit plans with funding rules that provide predictability.
    - Create voluntary automatic IRAs for small organizations.
    - Shore up Social Security.

For more information, please contact:
Rick Lawson
Vice President Federal Government Relations
The Principal Financial Group

About the Principal Financial Group

The Principal Financial Group® (The Principal ®)[14] is a global investment management leader offering retirement services, insurance solutions and asset management. The Principal offers businesses, individuals and institutional clients a wide range of financial products and services, including retirement, asset management and insurance through its diverse family of financial services companies. Founded in 1879 and a member of the FORTUNE 500®, the Principal Financial Group has $403.0 billion in assets under management[15] and serves some 18.3 million customers worldwide from offices in Asia, Australia, Europe, Latin America and the United States. Principal Financial Group, Inc. is traded on the New York Stock Exchange under the ticker symbol PFG. For more information, visit www.principal.com.

[14] "The Principal Financial Group" and "The Principal" are registered service marks of Principal Financial Services, Inc., a member of the Principal Financial Group.
[15] As of Dec.31, 2012

Appendix I
Worker Savings and Tax Implication Analysis
From the Principal Financial Group[16]

The following estimation is based on an average worker with access to a 401(k) plan and employer match throughout an entire working career.

$74,348	Amount of taxes the government would have received if the employee had not been allowed to defer 7% annually with 3% match ($265,529 x 28%).
$328,495	Tax collected on distributions on a 4.5% draw down rate of the total account balance over a 30 year period ($2,189,970 x **15% tax rate**).
$4.40 to $1	For every $1 of tax deferred, the government could get roughly $4.4 in the future ($328,495/$74,348= 4.418).
$437,994	Tax collected on distributions on a 4.5% draw down rate of total account balance over a 30 year period ($2,189,970 x **20% tax rate**).
$5.9 to $1	For every $1 of tax deferred, the government will get roughly $5.9 in the future ($437,994/$74,348= 5.891).

This analysis is a conservative estimate of the implications of tax deferred savings. Factors that would increase the ratio include:

- ***A lower marginal tax rate for the worker than the 28% assumption***. The marginal rate could be lower over the worker's career on average which would decrease the estimates of the current tax amount.
- ***A higher effective tax rate in retirement***. The assumed 15% and 20% tax rate could be low considering the likelihood of higher rates in the future.
- ***A higher draw down rate in retirement***. The assumed 4.5% draw down rate in retirement would leave a substantial remaining account balance for heirs. This remaining amount would eventually be taxed as well.

Assumptions[17]:

- Individual contributes to a 401(k) beginning at age 25 through age 65.
- Beginning salary of $30,000 with annual increase of 3.5 percent.
- Seven percent deferral rate and 3 percent match.
- Pre-retirement marginal tax rate of 28 percent, post-retirement effective of rate of 15 percent.
- Annual rate of return 7 percent.
- *This example is for illustrative purposes only. The assumed rate of return used is hypothetical and does not guarantee any* future *returns nor represent the return of any particular investment option.*

[16] Calculation by Principal Life Insurance Company, a member company of the Principal Financial Group

[17] Calculation performed by Principal Life Insurance Company